

SET SAIL For Continued And Steady Growth

By Emily Refermat, Editor

The office coffee service industry reached a record-breaking \$4.75 billion in annual sales due to a burgeoning economy, a sophisticated consumer palate and more options than ever. In 2014/2015 it also experienced the greatest percentage of growth in more than a decade.

It has been a tremendous growth year for office coffee service (OCS). In the second half of 2014 and the start of 2015, OCS revenues showed a jump of 5.5 percent over the previous year — a greater percentage of growth than in past years, including those preceding the Great Recession. The gain illustrates the opportunities in OCS, steered by economic factors motivating companies to provide quality coffee service to an expanding workforce. The record-breaking \$4.75 billion OCS industry is also being fed by coffee drinkers' discerning tastes, an array of single-cup brewer options and expanding into new services.

Green in beans and banks

Green coffee prices have been dropping since the end of 2014. The most recent International Coffee Organization (ICO) data, as of press time, cited a price of 199.77 cents per pound for the month of July. Record-breaking exports from coffee-producing countries is resulting in this price drop. However, the ICO also warns that overall stock levels are waning, which could leave the industry vul-

nerable to a rapid surge in price in the coming months.

Regardless of the uncertain future of green coffee prices, the drop in base price of this commodity has given operators a chance at better profit margins, which helps them cover costs in other areas of their businesses as well as expand into new services. A very large percentage, 82.5 percent of operators, reported increasing prices this year — quite a bit more than in the past two years. However, few of those increases were in coffee. Instead, operators felt the most pressure to raise prices in allied product areas. From paper goods to snacks and soda, the supplier cost increases in those categories drove the higher prices OCS providers needed to charge to protect profits.

The rise in costs for non-coffee products is especially relevant for today's OCS provider as that segment of the industry has steadily increased for the past few years. In 2015, we expanded the range of possible answers for operators to choose when talking about strategies for dealing with increasing costs and 9.2 percent indicated they most often added additional services to bolster

THE gain in revenues illustrates the opportunities in OCS.

CHART 1: OCS REVENUES – 10-YEAR HISTORY

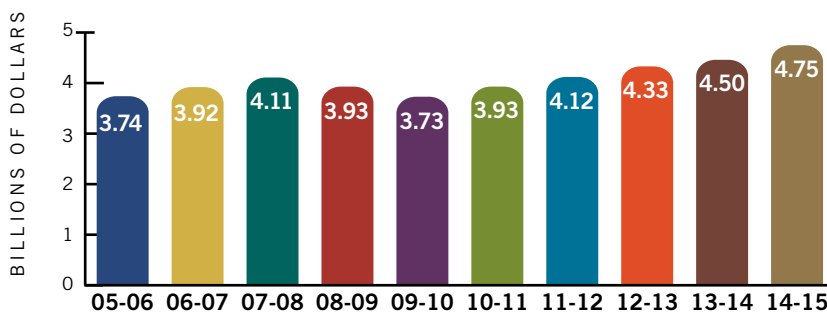
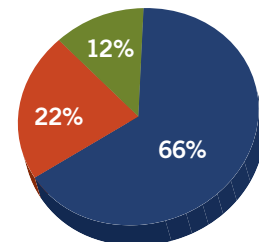
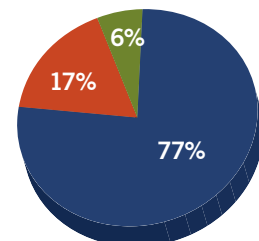


CHART 2: OPERATOR SALES CHANGE, 4-YEAR REVIEW

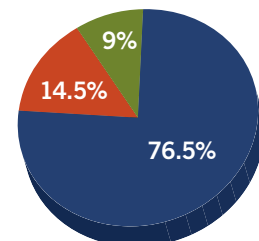
● SALES ROSE ● SALES DECLINED ● NO CHANGE



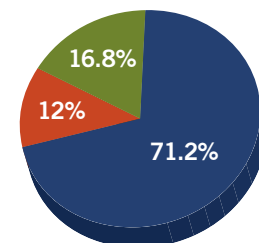
2010/11



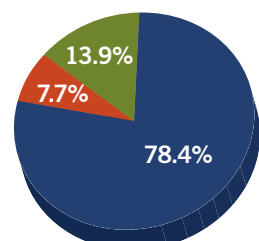
2011/12



2012/13

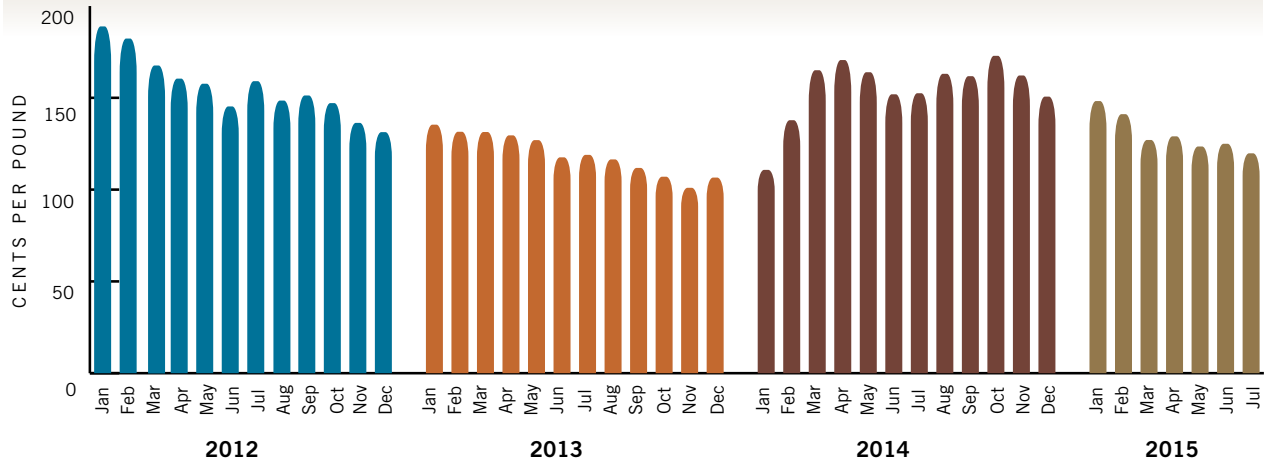


2013/14



2014/15

CHART 3A: COMPOSITE GREEN COFFEE PRICES, 2012 TO JULY 2015

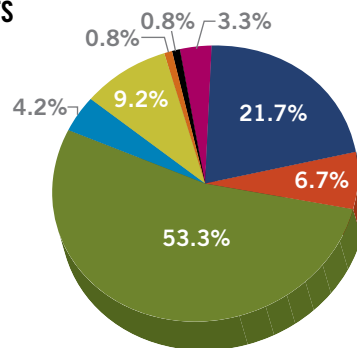


Source: International Coffee Organization, London, U.K.

their bottom line (chart 3B). Among the new services added by OCS providers were micro markets, added by 16.7 percent of respondents. More than half, 63.4 percent, of operators that provide OCS are operating one or more micro markets. In fact, micro markets were the most frequently added service, with water service and pantry service being close second and third options with 14.0 percent and 10.5 percent respectively.

CHART 3B: HOW RISING COSTS ARE BEING HANDLED

- RAISING PRICES
- ABSORBING
- COMBINATION
- ADJUSTING PRODUCT MIX
- SELLING ADDITIONAL SERVICES
- CHANGING WORKFORCE
- DIVESTING BUSINESS
- OTHER



*Other includes changing product mix, divesting business, workforce changes, etc.

New services divide market share

The addition of non-coffee products and services makes up a substantial percentage of the OCS industry revenues. Pantry service — commonly

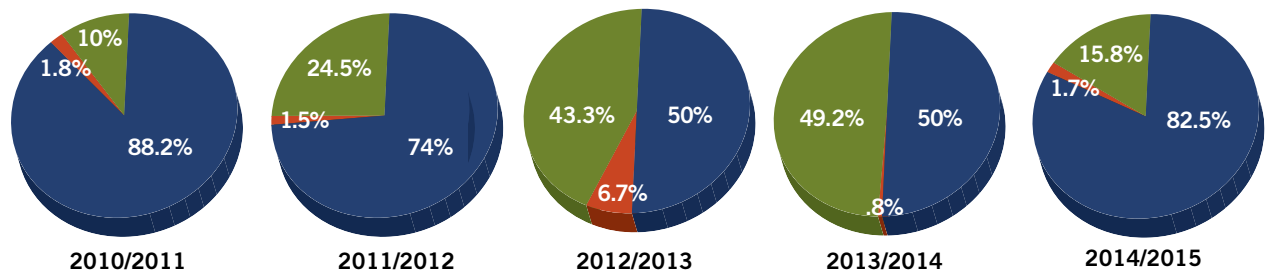
defined as delivering snacks, soda and other products to a location that employees enjoy freely while the workplace is invoiced for the items — has grown substantially. For

example, revenues associated with providing snacks and soda to locations have quadrupled (chart 5). Tea and water services have also added considerably to OCS revenues.

OPERATOR PRICING ACTIVITY

CHART 4A: OPERATOR PRICING ACTIVITY, 5-YEAR REVIEW

- RAISED PRICES
- LOWERED PRICES
- NO CHANGE



Adding new services was motivated by operators wanting to be proactive, a majority of respondents explained, rather than due to customer requests/market pressure. Most operators cited that they wanted to maximize their revenue-generating opportunities and/or wanted to stay at the leading edge of the industry.

Due to the growth in non-coffee, the levels of revenue generated by coffee in chart 5 appear to be slipping. Because total sales is out of 100 percent, the extreme decline in private label and national brands should be viewed more as evidence of product and service diversification, rather than a true decrease in interest for these segments of coffee. Indeed, demand remains very strong for both private label and national brands. Private label was rated the top-selling OCS product for the past 12 months by 27.3 percent of OCS operators (chart 5B). Clearly, locations are still asking for a value blend coffee from service providers. National coffee brands were top sellers for 24.7 percent of OCS providers showing a continued demand for consistent quality coffee with a nationally known name.

Drip is out, single-cup is in

Single-cup continues to grow. While the placement of single-cup brewers, which includes all models of countertop brew-by-the-cup equipment, has seen only a modest increase – 23.2 percent, up from 22.3 percent — the number of requests for single-cup service options has skyrocketed. Operators talked about dramatically different requests from locations seeking OCS than in previous years because everyone wants their customized coffee. In fact, most new customers ask about the single-cup and bean-to-cup options first, even if it is not the brewer ultimately placed.

In its latest *National Coffee Drinking Trends Report*, the National Coffee

CHART 4B: REVENUE PER CUP IN CENTS PER CUP, FRACTION PACK PLUMBED IN/POUROVER COFFEE, 5-YEAR REVIEW

	2010/2011	2011/2012	2012/2013	2013/2014	2014/2015
Revenue	10.8¢	11.7¢	11.8¢	12¢	12.4¢

*Previous numbers have been adjusted based on additional data

CHART 4C: REVENUE PER CUP, SINGLE-CUP COFFEE, 5-YEAR REVIEW

	2010/2011	2011/2012	2012/2013	2013/2014	2014/2015
Revenue	42.5¢	41.8¢	43.1¢	44.9¢	45.5¢

*Previous numbers have been adjusted based on additional data

CHART 5A: % OCS SALES BY PRODUCT CATEGORY, 5-YEAR REVIEW

	10/11	11/12	12/13	13/14	14/15
Private label coffee	28.1%	28.2%	18.2%	21.8%	12.7%
Local coffee brands				12.5	8.5%
National brand coffee	26.9	28.1	24.4	21.9	12.1%
Value frac packs				3.5	5.4%
Whole bean coffee					4.7%
Espresso/cappuccino	3.6	3.7	5.4	1.9	4.3%
K-cups				7.9	7.4%
Other single-cup				6.0	5.2%
Other coffee*	12.1	9.9	17.4	4.8	6.0%
Total Coffee	70.7	69.9	65.4	80.2	66.4%
Other hot beverages	4.9	5.5	6.4	4	3.3%
Soft drinks/juices	5.4	5.7	6.6	1.8	4.5%
Bottled/filtered water	5.7	4.8	7.3	3.9	5.3%
Creamers/sweeteners	5.6	6.6	6.5	5.2	4.5%
Cups/paper products	5.4	6.2	6.5	4.5	3.8%
Tea					3.6%
Water Service					4.9%
Other	2.3	1.3	1.9	0.4	3.6%

*Includes flavored and varietal.

CHART 5B: TOP-SELLING OCS PRODUCT FOR PAST 12 MONTHS

	2014/2015
Local coffee brands	13.0%
Private label	27.3%
Value frac packs	2.6%
Specialty drinks	1.3%
Whole bean	5.2%
National brand coffees	24.7%
K-Cups	16.9%
Single-cup	5.2%
Tea	0.0%
Water	0.0%
Other	3.9%

PRIVATE
label coffee was rated the top-selling product by over 25% of OCS providers.

CHART 6: PLUMBED-IN, AUTOMATIC AND THERMAL AS % OF TOTAL, 5-YEAR REVIEW

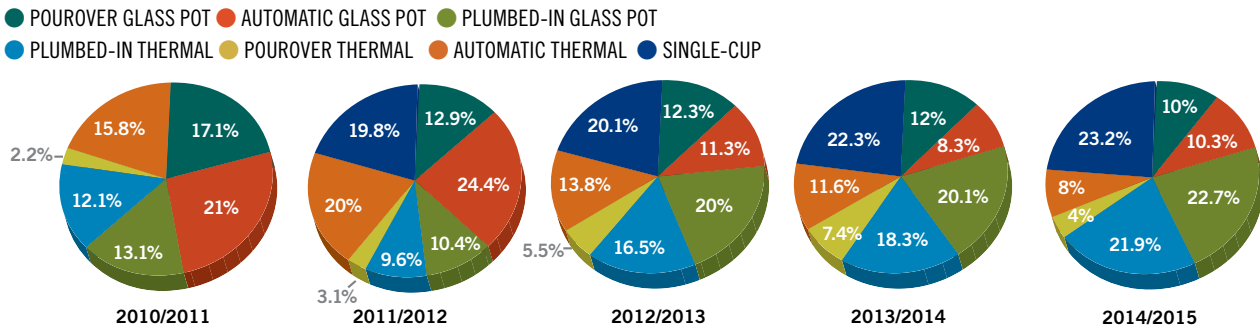


CHART 7: ESTIMATED MARKET SHARE OF SINGLE-CUP BREWER PLACEMENTS IN THE U.S., 5-YEAR REVIEW

MARKETER	PRODUCT(S)	2010/11	2011/12	2012/13	2013/14	2014/15	% Change
Bodecker Brewed	Bodecker	0.2%	0.3%	0.4%	0%	2.5%	2.5%
BUNN	Single serve pod brewers				1.6	2	0.4
Cafection	Avalon	4.1	3.9	2	3.3	6.4	3.2
Cafejo	Cafejo	2.2	2.4	2.4	0.0	0.1	0.1
Technologies Coffea	Coffea					0.3	
Crane	Café System, Genesis	1.1	1	1.3	0.3	5.2	4.9
De Jung Duke	Virtu				0.8	1.2	0.4
Filterfresh	Filterfresh	1.7	1.4	4.7	2.9	1.2	-1.7
Grindmaster	Grindmaster	1.2	1.4	6.0	0.1	1	0.9
JM Smucker's	Douwe Egberts					2.9	
Keurig	Keurig	43.0	46.2	46.2	39.6	30.0	-9.6
Kraft	Gevalia, Tassimo Professional	0.7	0.8	2.9	3.9	9.8	5.9
Lavazza	Espresso Point, Lavazza Blue	2.0	1.7	2.1	0.4	5.3	4.9
Mars Drinks	Mars Drinks (Flavia)	31.8	30.1	23.4	37.5	16.8	-20.7
Newco	Smartcup, Freshcup, CX-3	0.3	0.4	2.2	1.7	4.3	2.6
Rheavendors	Rhea, Cino	0.4	0.3	0.1	0	0	0
Saeco USA	Saeco, Estro	2.2	2.0	0.6	0.0	0.5	0.5
Starbucks	Starbucks	0.8	0.8	1.6	2.6	2.7	0.1
Technologies Coffea	Coffea	0.2	0.2	0.0	0.0	0.3	0.3
VE Global Solutions	Brio, Colibri, Cypris, Juno, Koro, Korinto, Kinvivo, Prosy, Venus	1.9	1.6	0.1	1.9	4.9	3
VKI Technologies	Eccellenza Express, Eccellenza Touch, Eccellenza Cafe					1.2	1.2
Wolfgang Puck	Wolfgang Puck	0.2	0.3	0.3	0.1	0.3	0.2
Other		0.3	0.2	0.8	0.8	1.1	0.3

*Represents OCS provider placements only

fee Association (NCA) indicated that 34 percent of consumers consider a single-cup brewer to be the preferred coffee preparation method at work, followed by ground coffee with 29 percent. The variety of coffee options available with single-cup as well as it being a fast and convenient option are driving this perception, accord-

ing to NCA data. The report also suggests the consumer understands that single-cup isn't a low cost option. This would suggest that the location would be more open to paying the higher single-cup prices when asking for this type of coffee service.

This spike in single-cup requests from locations reflects the evolving

coffee preference of today's consumer. Words like *fresh*, *greater variety*, *premium* and *specialty* were listed by operators as key reasons for the current trends in coffee service locations. Much of today's new single-cup equipment meets these needs. Cartridge-style solutions ensure quality control and offer a location a broad variety.

Access to local or premium non-cartridge roasts, however, is better met with a bean-to-cup machine.

Successful operators in the single-cup segments report holding sampling events, offering local roasts not available in cartridge-style single-cup, providing greater hot beverage variety in one machine, being a one-stop for all service (not just coffee) and placing high-end, sophisticated equipment.

Single-cup was rated as the fastest-growing category of OCS while traditional coffee and water service were ranked second and third fastest-growing, respectively. Although single-cup is a fast growing segment, operators rank it second in overall contributions to revenues to traditional coffee which is the clear leader. The challenge with single-cup is making a good margin. Widely available cartridge-style cups can be expensive for operators, making the prices they charge look high compared to online and office supply retailers.

The bean-to-cup systems are sophisticated brewers that require

CHART 8: ACCOUNT POPULATIONS BY SIZE

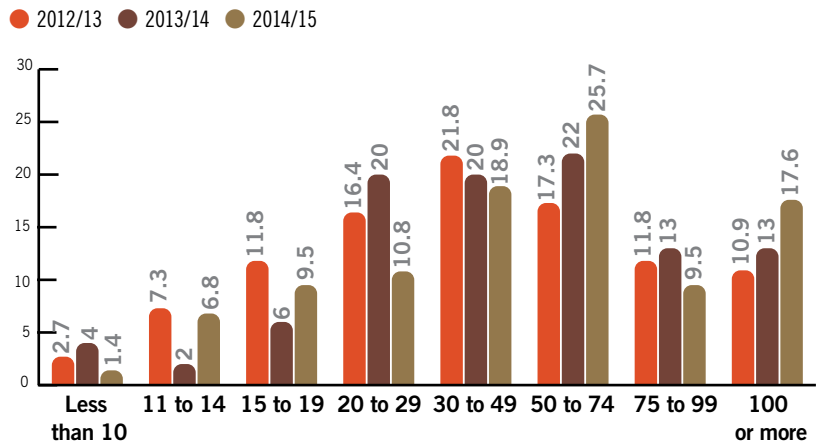


CHART 9: ACCOUNTS BY TYPE, 5-YEAR REVIEW

	2010/11	2011/12	2012/13	2013/14	2014/15
Offices	55.4%	55.8%	48.8%	45.0%	47.4%
Industrial plants	18.5	18.7	15.1	17.3	17.1
Restaurants, delis, bakeries	6.2	4.5	6.3	7.3	8.5
Convenience stores	3.5	5.2	7.2	8.3	4.7
Government/military	1.5	3.3	5.4	3.5	3.3
Schools/colleges	4.8	3.8	5.2	5.4	6.7
Retail outlets	1.4	1.9	2.11	2.7	5.8
Other (Health care/hotels)	7.6	6.9	10.1	10.5	6.5

FUEL CHARGE ACTIVITY

CHART 10A: COMPANY BILLED CUSTOMERS FOR FUEL, 5-YEAR REVIEW

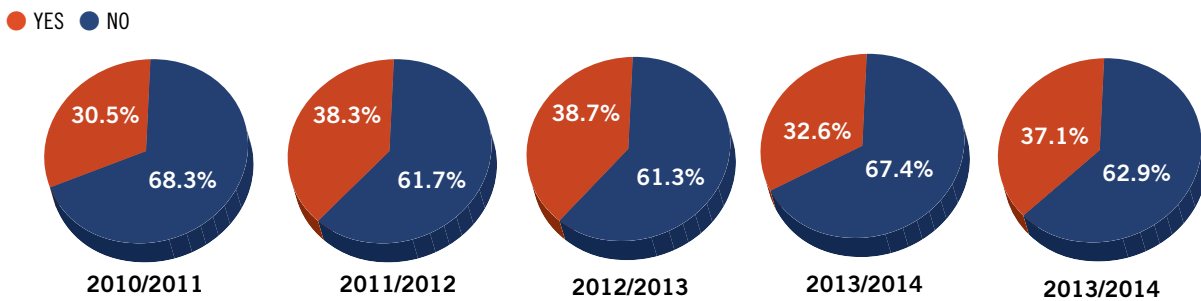


CHART 10B: AVERAGE AMOUNT CHARGED FOR FUEL PER DELIVERY, 5-YEAR REVIEW

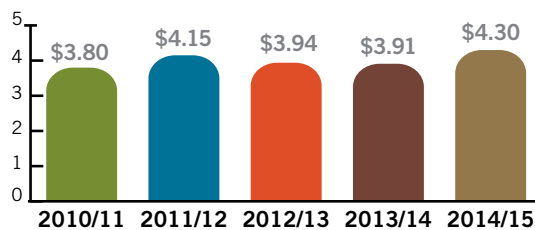


CHART 11A: HAVE ADDED OR REDUCED STAFF IN THE LAST 12 MONTHS

● ADDED ● REDUCED ● NO CHANGE

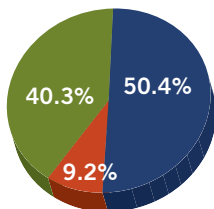
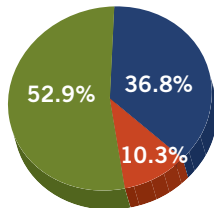
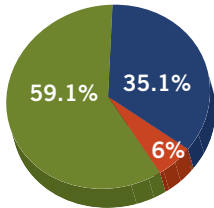


CHART 11B: IF ADDED STAFF, IN WHICH AREAS?

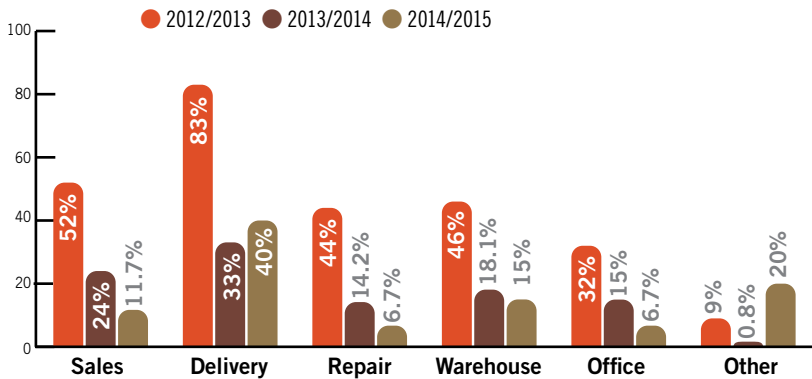
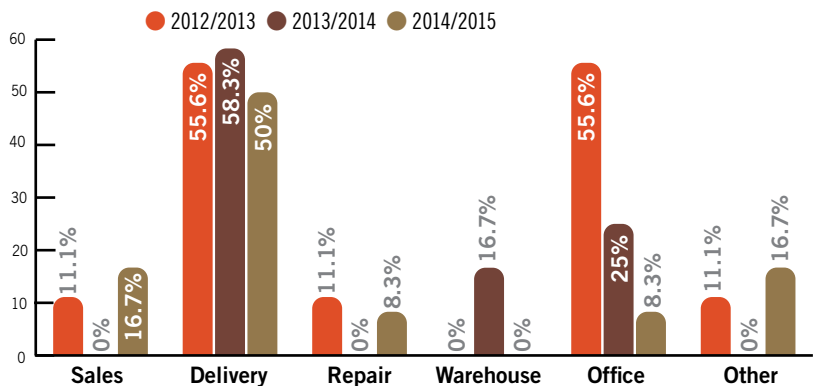


CHART 11C: IF REDUCED STAFF, WHICH AREAS?



regular cleaning and maintenance to ensure the high performance for which they're known. Operators must factor in this added service commitment when determining a price for clients. Both of these issues are causing single-cup service not to boom in OCS — at least steadily across the country. Most operators, however, are recognizing it as a viable solution that fits the needs and requests of many locations.

Coffee perception increases opportunities

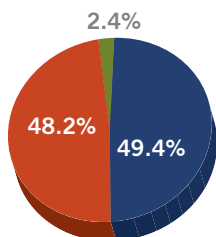
The number of locations served by OCS providers increased in 2014 to 2015. Much of this was due to consolidation in the industry, but based on operator comments, a majority was from marketing and sales efforts made by management. Many altered the way their company solicited new business. More resources were dedicated to marketing, including

new company Websites that include better SEO (search engine optimization) making it easier for customers to find them/their service when searching online. Websites were also enhanced with online ordering features, which drove sales (chart 13).

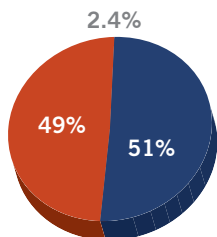
Locations identified by size also saw a change this year, said operators (chart 8). Smaller workplaces grew into larger ones, driving up the percentage of 11 to 9 person accounts

CHART 12A: HAVE ADDED PRODUCTS THAT ADDRESS ENVIRONMENTAL CONCERNS, 5-YEAR REVIEW

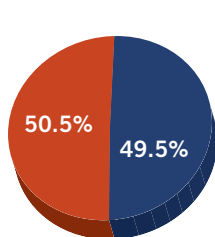
● YES ● NO ● DON'T KNOW



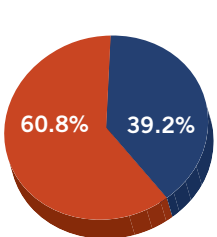
2010/2011



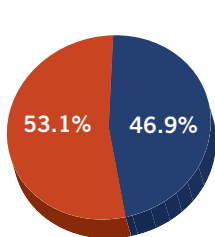
2011/2012



2012/2013



2013/2014



2014/2015

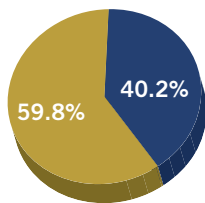
served. The 100 plus locations also showed a substantial gain driving up same location sales revenues.

Office locations still lead the OCS marketplace, comprising 47.4 percent of revenues for OCS providers (chart 9). That is higher than in previous years, likely due to the gains in the economy and expanding workforces in white collar America. Since July 2015, 27,000 professional and technical service jobs have been added equating more than 300,000 over the past 12 months, according to the U.S. Bureau of Labor and Statistics. This pushes the coffee service industry upwards for that segment.

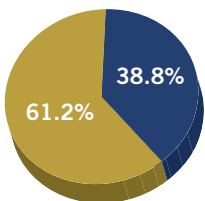
For the remaining location types, most stayed relatively steady, such as industrial plants which made up 17.1 percent of business, compared to last year's 17.3 percent. Convenience store service saw the most severe drop

CHART 13: COMPANY CURRENTLY OFFERS ONLINE ORDERING ON ITS WEBSITE

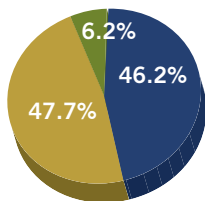
● YES ● NO
● DON'T HAVE A WEBSITE



2012/2013



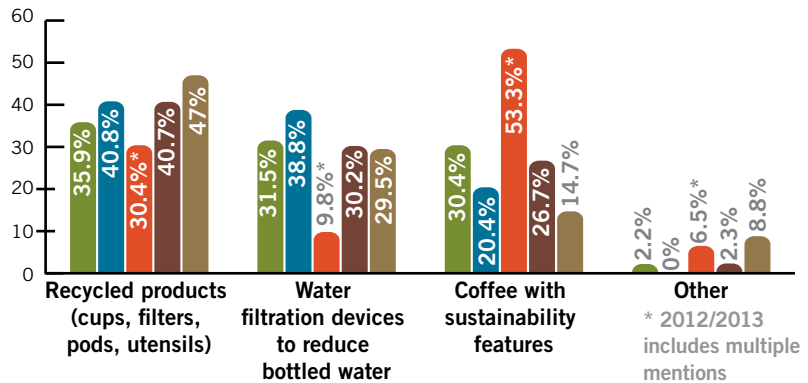
2013/2014



2014/2015

CHART 12B: PRODUCTS ADDED THAT ADDRESS ENVIRONMENTAL CONCERNS, 5-YEAR REVIEW

● 2010/2011 ● 2011/2012 ● 2012/2013* ● 2013/2014 ● 2014/2015



of 3.6 percentage points with operators moving towards other retail outlets instead, which saw an increase of 3.1. According to NCA drinking trend data, consumers tend to rank quality low on the list when expressing why they buy coffee at a convenience store. This perception could be a contributing factor to the decline in OCS providers servicing convenience stores.

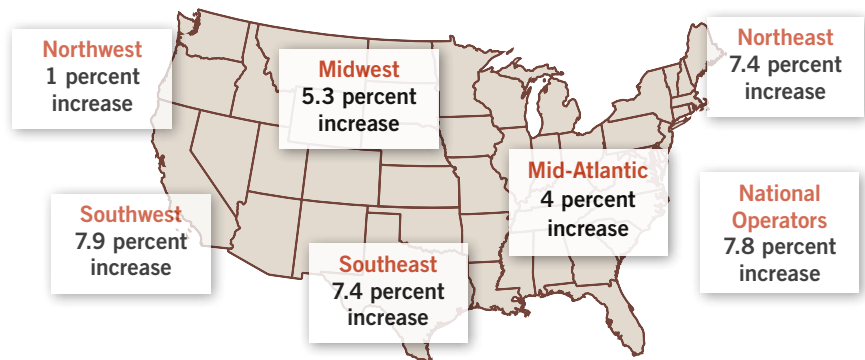
Final thoughts

While few of the charts in this report show technology use, it's important to point out that its prevalence is increasing in OCS as well as other industry segments like vending. Operators are investing in OCS software. In 2015,

35.9 percent indicated that they use an industry-specific software system and 4.7 percent use the same system for both OCS and vending. Adding a software system usually produces a more efficient and cost-effective operation, driving up profitability.

Competitive pressures — from coffeehouses and office supply companies, for example — are the greatest challenges for OCS. OCS providers are able to compete by dedicating sales resources and building sales models with value-added amenities. This focus, coupled with meeting the needs of consumers who pine for customized, quality coffee, will keep OCS on course. | ◀

Average Total Sales Revenue Change Per Region



Methodology

The *Automatic Merchandiser* State of the Coffee Service Industry Report is compiled from a survey sent to OCS operators, as well as operator interviews. The 2015 report is based

on a 5.5 percent response rate to the survey and includes full-service vending operators who offer OCS as well as operators who only provide coffee service.